DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 05-0298
SALES AND USE TAX
For Tax Period 2001-2002

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Issue

I. Sales and Use Tax – Rented Linens

Authority: IC § 6-8.1-10-2.1; IC § 6-2.5-3-2; IC § 6-2.5-4-10(a).

The Taxpayer protests the imposition of use tax on rented linens.

II. Sales and Use Tax – Maintenance Agreements

Authority: IC § 6-2.5-3-2; 45 IAC 2.2-4-2; Sales Tax Information Bulletin #2, issued November, 2000.

The Taxpayer protests the imposition of use tax on maintenance agreements.

III. Sales and Use Tax – Bariatric Beds and Equipment

Authority: IC § 6-2.5-5-18(b); 45 IAC 2.2-5-27(b).

The Taxpayer protests the imposition of use tax on bariatric beds and equipment.

IV. Sales and Use Tax – Doormats

Authority: IC § 6-2.5-2-1(a).

The Taxpayer protests the imposition of use tax on doormats.

V. Sales and Use Tax – Information Transferred by Compact Disc

Authority: IC § 6-2.5-3-2; Sales Tax Information Bulletin #8, February 9, 1990, and reissued May 2002.

The Taxpayer protests the imposition of use tax on information transferred by Compact Disc.

VI. Tax Administration- Negligence Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2(b)(c).

The taxpayer protests the imposition of the negligence penalty.

Statement of Facts

The taxpayer was a limited partnership that operated hospitals and pharmacies. Pursuant to an audit, the Indiana Department of Revenue, hereinafter referred to as the "Department," assessed additional use tax, interest, and penalty for the tax period 2001-2002. The Taxpayer also requested a refund of sales taxes paid on some items. The taxpayer protested the assessments and the denial of the refund claims. A hearing was held. This Letter of Findings results.

I. Sales and Use Tax – Rented Linens

Discussion

The Department assessed use tax on the Taxpayer's use of rented linens. The Taxpayer protested these assessments contending that sales tax had been paid on all the rentals.

Indiana Department of Revenue assessments are prima facie evidence that the tax assessment is correct. IC § 6-8.1-5-1(b). The taxpayer bears the burden of proving that the assessment is incorrect. Id.

Use tax is imposed on the use of tangible personal property purchased in retail transactions in Indiana on which no sales tax was collected from the purchaser. IC § 6-2.5-3-2. Rentals of tangible property are described as retail transactions for purposes of sales and use tax. IC 6-2.5-4-10(a). Therefore, if no sales tax is collected on a rental transaction, use tax is due on the use of the tangible personal property acquired in the rental transaction.

The Taxpayer rented linens such as sheets, blankets, towels, and gowns from two companies. Prior to the hearing, the Taxpayer produced substantial documentation indicating that the rental companies actually collected sales tax from the Taxpayer on the linen rental. Since sales tax was paid on the rental transactions, the Taxpayer's use of the linens is not subject to the imposition of use tax.

Finding

The Taxpayer's protest is sustained as to the rentals where the taxpayer showed that sales tax was paid on the rental transactions.

II. Sales and Use Tax – Maintenance Agreements

Discussion

The Department assessed use tax on certain optional maintenance/service agreements for ventilators pursuant to IC § 6-2.5-3-2. The Taxpayer protested this assessment.

The Department's interpretation of the application of the sales and use tax to optional maintenance/service agreements is explained in Sales Tax Information Bulletin #2, issued November, 2000 as follows:

> Optional warranties and maintenance agreements that only contain the intangible right to have property supplied and there is no certainty that property will be supplied are not subject to sales tax. . . .
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> where in conjunction with rendering services a service provider also transfers tangible personal property for a consideration, this will constitute a retail transaction unless:
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> 1. The service provider is in an occupation that primarily furnishes and sells services, as distinguished from tangible personal property;
> 2. The tangible personal property is used or consumed as a necessary incident to the service;
> 3. The price charged for the tangible personal property is inconsequential (not to exceed 10 [per cent]) compared with the service charge; and
> 4. The service provider pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.
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> . . .
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> If the provisions contained in the warranties or agreements are not in complete compliance with all provisions of Rule 45 IAC 2.2-4-2, this will constitute a transaction of a retail merchant selling at retail. Thus, the service provider must collect sales tax on the unitary price pursuant to IC § 6-2.5-2-1.

To determine if a particular optional warranty/service agreement is subject to the sales and use tax, one must look to the circumstances to determine the taxability. The Taxpayer presented the contracts for the two agreements in question. Optional Warranty - One included language indicating that the Taxpayer's ventilator would have its battery pack and oxygen sensor replaced on a regular schedule. Taxpayer would receive regular software updates and all parts required for routine maintenance work. The Taxpayer did not demonstrate that the value of the tangible personal property transferred in the performance of the maintenance work was an inconsequential portion of the cost of the warranty or that the service provider paid use tax on the tangible personal property. Since the Taxpayer did not demonstrate that the transfer was in compliance with 45 IAC 2.2-4-2, the service provider should have collected and remitted sales tax. Since the service provider did not collect and remit the sales tax, the Department properly imposed the complementary use tax on the optional warranty.

The contract for Optional Warranty - Two included the following language in 2(c) of Exhibit B:

> Disposable or user parts that must be routinely replaced, including but not limited to patient circuits, batteries and filters are not provided by this coverage unless specified by the service option.

The contract further states at 3 of Exhibit B as follows:

> [Service provider] will repair or replace products or parts serviced hereunder to the extent deemed necessary by [service provider] to remedy any defects in services or parts installed as part of the original service, repair or replacement.

This language makes it clear that there is no guarantee that tangible personal property would be transferred pursuant to this optional warranty. The contract states that tangible personal property needed for routine maintenance is not included in the warranty. Further, the contract states that there is only a possibility that tangible personal property would be transferred pursuant to this contract to make repairs if defects appear.
Optional Warranty - Two is not subject to the sales or use tax.

Finding

The taxpayer's protest is respectfully denied as to Optional Warranty - One and sustained as to Optional Warranty - Two.

III. Sales and Use Tax – Bariatric Beds and Equipment

Discussion

The Taxpayer paid sales tax on the rental of bariatric beds and other bariatric equipment. During the audit process, the Taxpayer requested a refund of the sales taxes paid on these items. The Department denied that request. The Taxpayer protested the denial.
The Taxpayer contends that the bariatric beds and other bariatric equipment qualify for exemption from the sales tax pursuant to IC § 6-2.5-5-18(b) as follows:

> Rentals of durable medical equipment and other medical supplies and devices are exempt from the state gross retail tax, if the rentals are prescribed by a person licensed to issue the prescription.

For the purposes of sales and use tax, the term "prescription" is defined in the Regulations at 45 IAC 2.2-5-27(b) as follows:

> The term "prescribed" shall mean the issuance by a person described in paragraph 1 of this regulation of a certification in writing that the use of the medical equipment supplies and devices is necessary to the purchaser in order to correct or to alleviate a condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body.

The Taxpayer argued that it qualified for this exemption because physicians wrote prescriptions for particular patients to use the bariatric beds and equipment. Those particular patients suffered from the disease of obesity. According to the definition of "prescribed" for sales and use tax purposes, the bariatric equipment could only be prescribed by a physician if the equipment were used to treat the medical condition of obesity. The bariatric beds and bariatric equipment were larger and sturdier. They stood up under the additional weight and stress of the obese patients. The bariatric beds and other bariatric equipment did not, however, have any therapeutic purpose. They did not aid in the alleviation or correction of the patients' medical condition of obesity. Therefore, they could not be "prescribed" as that term is used for sales and use tax purposes.

Finding

The taxpayer's claim for refund of sales taxes paid is respectfully denied.

IV. Sales and Use Tax –Doormats

Discussion

The Department also assessed use tax on the rental of doormats. The taxpayer contends that the Department improperly imposed the tax on the provision of a service, the cleaning of the doormats.

Indiana imposes a sales tax on retail transactions in Indiana. IC § 6-2.5-2-1(a). There is no sales tax imposed on a service. The cleaning of property owned by the taxpayer is a service that generally is not subject to sales or use tax.

The taxpayer did not, however, provide any documentation substantiating its contention that the charges were actually for the service of cleaning the taxpayer's doormats rather than the rental of doormats. Therefore, the Taxpayer did not sustain its burden of proving that the Department improperly imposed use tax on the rental of doormats.

Finding

The Taxpayer's protest is respectfully denied.

V. Sales and Use Tax – Information Transferred by Compact Disc

Discussion

The Taxpayer purchased digital information on compact discs. The Taxpayer used this information to prepare pharmaceutical instructions for distribution to patients at the time of their release. The Department assessed use tax on the Taxpayer's use of the information on compact discs pursuant to IC § 6-2.5-3-2. The Taxpayer argued that it actually purchased and used a non-taxable service rather than taxable tangible personal property.

The Department's interpretation of the sales and use taxability of information purchased in an electronic format is found in Sales Tax Information Bulletin #8, February 9, 1990 and reissued in May, 2002 as follows:

> The sale of statistical reports, graphs, diagrams or any other information produced or compiled by a computer and sold or reproduced for sale in substantially the same form as it is so produced is considered to be the sale of tangible personal property unless the information from which such reports was compiled was furnished by the same person to whom the finished report is sold.

Pursuant to these instructions, the Taxpayer would be purchasing a service if it owned information which the service provider reorganized for a fee and then returned in the newly organized format to the Taxpayer. In this case, the Taxpayer actually purchased pharmaceutical information that happened to be transferred by compact disc. Under the interpretation of Sales Tax Information Bulletin #8, the Taxpayer purchased tangible personal property. As such, the use of this information when sales tax was not collected at the time of transfer was subject to imposition of use tax.

Finding

The Taxpayer's protest is respectfully denied.

VI. Tax Administration-Imposition of Negligence Penalty

Discussion

The Taxpayer protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;

(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

The Taxpayer provided substantial documentation to indicate that the negligence penalty does not apply in this situation.

Finding

The Taxpayer's protest is sustained.

KMA/BK/DK – December 1, 2006